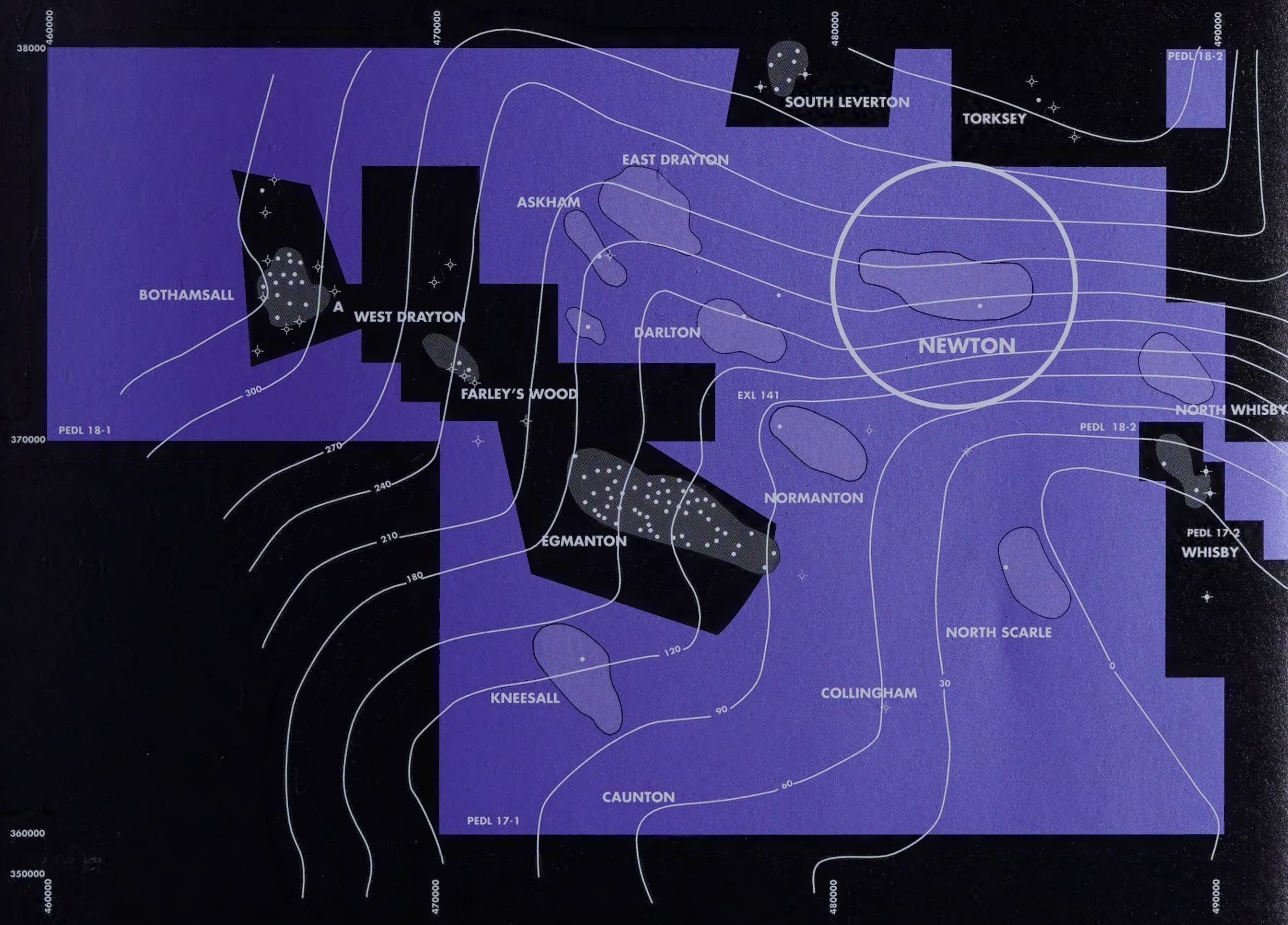
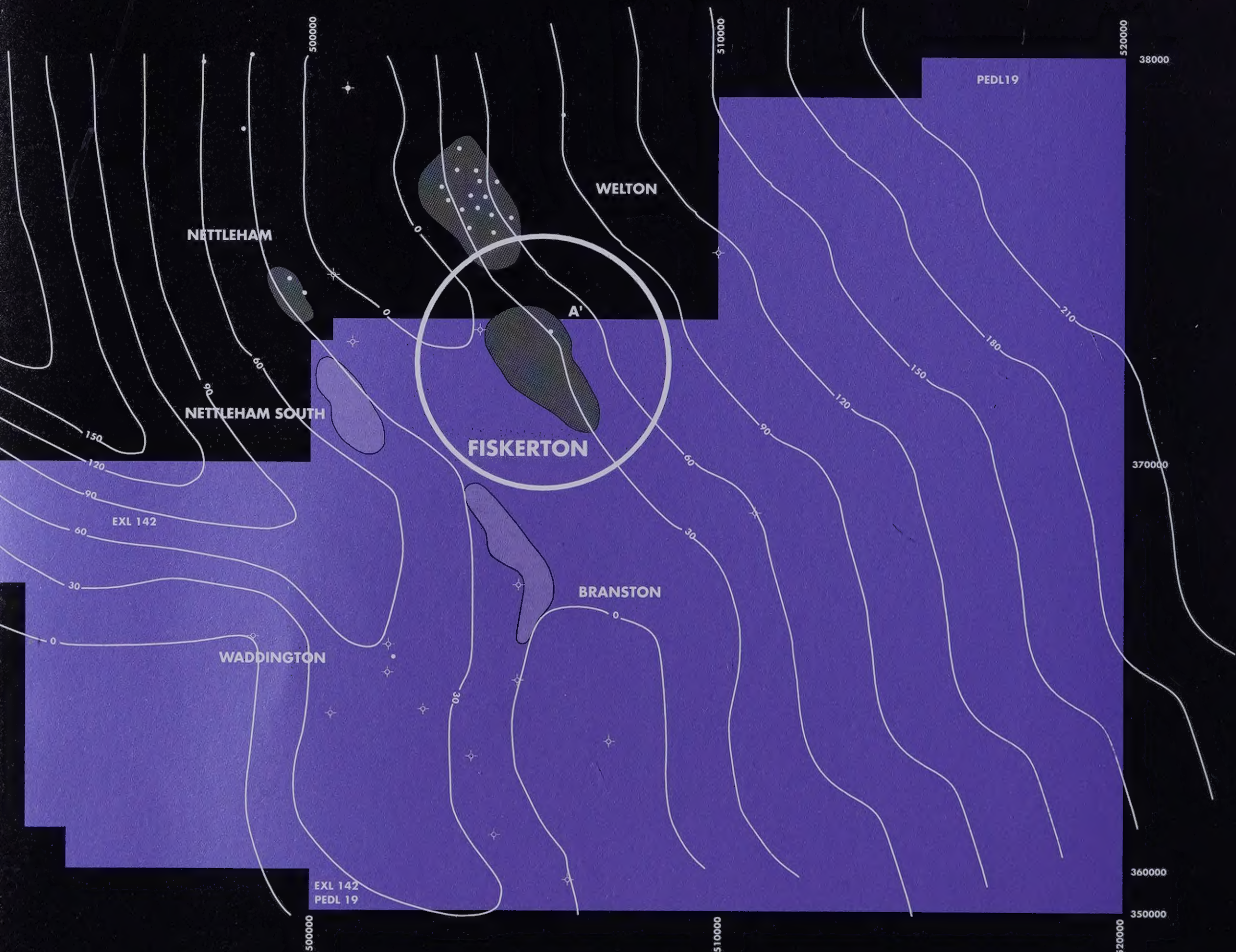
AltaQuest Energy Corporation



997 *Annual Report*

Is Driven By Long-term Vision



Recent Exploration Success

AltaQuest achieved outstanding exploration success in 1997 with a major oil pool discovery on its large, undeveloped land block in the East Midlands, United Kingdom. Results from the Fiskerton Airfield #1 well indicate that this discovery is important for the Company as the pay column and features are similar to the nearby Welton pool that has produced 12 million barrels to date. The well is located within two kilometers of a major processing facility in an area with excellent infrastructure which will permit production to be converted into cash flow in the year ahead. AltaQuest is currently shooting a 3D seismic program in the area, and plans to initiate a five well delineation program off the initial pad in the second quarter of 1998.

On February 26, 1998, AltaQuest was awarded seven new oil and gas licenses adjacent to its existing acreage in the United Kingdom that increases its land holdings by 196,000 acres (83,000 net) to 442,000 acres (168,000 net). The Company plans to shoot 210 kilometers of 2D seismic on this acreage, and expects to drill at least eight exploratory wells over the next three years. The first well began drilling at Newton-on-Trent to test a new geological feature in March 1998.

Corporate Profile

AltaQuest Energy Corporation is a quickly evolving junior energy company exploring for high quality, long-term, crude oil and natural gas reserves both domestically and internationally. As of December 31, 1997, the Company had acquired 1,700,000 BOE of proven plus probable reserves and 635 BOE/d of production. Its exploration efforts are focused in the East Midlands, United Kingdom and Sylvan Lake, Alberta. Since its initial public offering in May 1997, the Company has made a major discovery at Fiskerton, United Kingdom that will be a springboard for substantial growth in 1998, it has also completed several producing property acquisitions in Western Canada that will generate cash flow to support its exploration program. AltaQuest is listed on The Alberta Stock Exchange under the symbol "AQF".

Contents

Notice of Annual Meeting

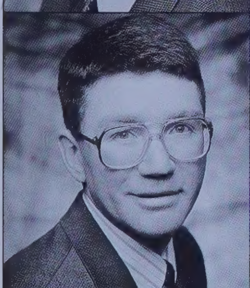
AltaQuest is pleased to invite its shareholders and other interested parties to its Annual General Meeting to be held on Tuesday, May 19th, 1998 at 3:30 p.m. (local time), in the Cardium Room at the Calgary Petroleum Club, 319 - 5th Avenue S.W., Calgary, Alberta.

Management Strength

AltaQuest has a dedicated and experienced management team, and the majority of the key players have been part of the Company since inception. The synergies created by bringing these individuals together have enabled AltaQuest to achieve early exploration success and set an aggressive pace for growth.

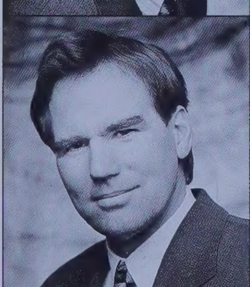
John Thompson *President, Director & Chief Executive Officer*

Mr. Thompson has had an extensive nineteen year career in the oil and gas industry, and was most recently Vice-President, Production for Jordan Petroleum Ltd. For six years previous to joining Jordan, he was Engineering Manager for Poco Petroleums Ltd., and held a similar position at Voyager Energy Inc. after being promoted from Senior Engineer. He has also held various engineering positions with increasing responsibilities at Ocelot Industries Ltd. and Gulf Canada Resources Limited. Mr. Thompson graduated from the University of Alberta with a Bachelor of Science in Petroleum Engineering in 1982 and in Geology in 1977.



Neale Cruickshank *Vice-President, Finance & Chief Financial Officer*

Mr. Cruickshank joined AltaQuest's management team in February 1998, and brings over fifteen years of experience in financial accounting to the Company. He was previously Controller for Jordan Petroleum Ltd. from 1987 to 1998, and held the position of Assistant Controller at Trans-Canada Resources Ltd. for a five year period prior to joining Jordan. Mr. Cruickshank became a member of the Institute of Chartered Accountants of Alberta in 1983, and graduated from the University of Saskatchewan with a Bachelor of Commerce in 1978.



Damon Olsen *Vice-President, Exploration*

Mr. Olsen has been active in the energy industry for over twelve years, and prior to joining AltaQuest in 1996, was a Senior Exploration Geologist with Stampeder Exploration Ltd. for a two and a half year period. Before joining Stampeder, he was an Exploration Geologist with Altana Exploration Company, Pacific Enterprises Oil Company, and PanCanadian Petroleum Ltd. from 1985 to 1994. He graduated from the University of Alberta with a Bachelor of Science with Honours in Geology in 1985.

Daniel Wilson *Vice-President, Engineering*

Mr. Wilson has twelve years of engineering and operations experience in the energy industry. Prior to starting with AltaQuest in 1996, he was an engineering consultant with Tarragon Oil and Gas Limited. From 1993 to 1995, he held the positions of Engineering Manager and Senior Operation Engineer at Barrington Petroleum Ltd. Previously, he was employed in various capacities at BP Resources Canada Ltd. over a seven year period. Mr. Wilson graduated from the University of Saskatchewan with a Bachelor of Science with Distinction in Chemical Engineering in 1986.

President's Message

During its first full year of operations, AltaQuest has achieved numerous milestones in its corporate development that include realizing early exploration success in onshore United Kingdom. A major discovery was made at Fiskerton in the East Midlands during the fourth quarter of 1997 that has positioned the Company to generate significant production, cash flow, and reserve additions in the year ahead. AltaQuest has an inventory of prospects in the area, and was recently awarded seven new oil and gas licenses in the vicinity of its current acreage that hold additional exploration potential. During the year, the Company also added several producing properties to its asset base that will form the foundation for growth domestically and abroad.

1997 Highlights

From a concept that began in late 1996 to the following accomplishments, AltaQuest is proving to be a strong competitor in the energy industry:

- AltaQuest successfully completed its initial public offering on May 8, 1997 for gross proceeds of $2.5 million that were directed towards both drilling and acquisitions.
- A major oil pool discovery was announced in November 1997 at Fiskerton, United Kingdom early in the Company's history. This is a high impact exploration play with significant recoverable reserves.
- The Company spent $11.5 million to accumulate 1,700,000 BOE of proven plus probable reserves and 635 BOE/d of oil and gas production as of December 31, 1997 through a series of strategic acquisitions in Western Canada.

International Exploration in 1998

To build on its success at Fiskerton, AltaQuest shot a 16.5 square kilometer seismic program for $1.0 million covering the targeted area that is expected to be processed and interpreted by mid 1998. Five delineation wells will be drilled off of the existing pad starting in June, and if successful, will be brought on-stream immediately. AltaQuest estimates that production from the area will reach 630 Bbls/d by the end of the year, and that at least three more exploration wells will be drilled in the vicinity during 1998. For further details on Fiskerton, see page 5 of this annual report.

In February 1998, AltaQuest was awarded an additional seven oil and gas licenses surrounding its East Midlands acreage that enhances its undeveloped land position. The Company is now evaluating sixteen exploration prospects, and expects to drill three wells (1.5 net) to test new prospects in the year ahead. The first well, Newton-on-Trent, is located approximately 20 kilometers west of Fiskerton, and will test similar but separate geological features. AltaQuest owns a 50% after payout interest in the well that will reach total depth in the second week of April 1998.

Domestic Activities

In Western Canada, AltaQuest has focused on building its production base in a well established area near Sylvan Lake, Alberta. The Company's strategy is to acquire producing properties domestically to support its higher risk/higher reward international exploration efforts. AltaQuest's Sylvan Lake area produces high quality crude oil, natural gas and NGLs. While it is currently dominated by a number of major oil and gas companies, this area contains great potential because AltaQuest expects the majors to rationalize their interests over the next few years due to the maturity of the reservoirs. This will enable the Company to build a substantial land position over time and increase its production and reserves through technically advanced exploitation and selective exploratory drilling.

Effective December 1, 1997, AltaQuest completed a significant acquisition at Sylvan Lake for a 62% working interest in and operatorship of a 14 Mmcf/d gas plant, a 20 kilometer pipeline, 300 BOE/d of production, and 1,000,000 BOE proven plus probable reserves. Exploitation of this property in 1998 will consist of well recompletions, development drilling and plant optimization. AltaQuest plans to drill five wells in 1998 which coupled with the above activities should increase production from this area to a targeted exit rate of 750 BOE/d.

Closing Comments

AltaQuest had an exciting year of growth highlighted by significant exploration success in 1997. With the "company making" potential of Fiskerton and new opportunities such as Newton-on-Trent, AltaQuest believes that it will create significant, long-term value for the shareholders in the years ahead. The Company's goal is to increase its exit 1998 production to 1,500 BOE/d with a product mix of 40% gas and 60% oil due to new production from the United Kingdom and higher volumes from Sylvan Lake. In closing, AltaQuest thanks its management team and employees for their outstanding contributions over the past year, and looks forward to sharing in its success with the shareholders.

On Behalf of the Board of Directors,

John Thompson,
President
March 22, 1998

AltaQuest at a Glance

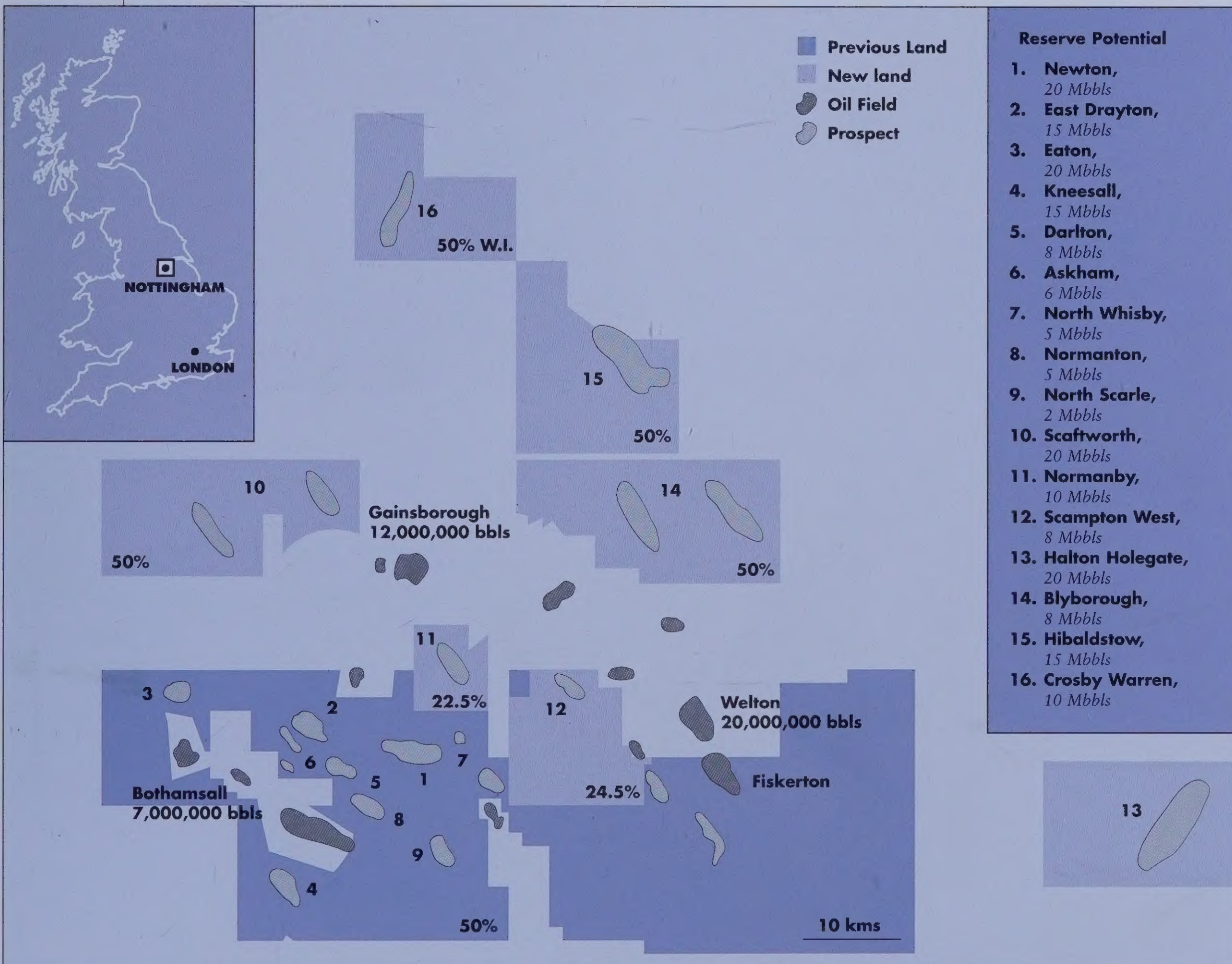
In conducting full cycle exploration, the Company believes it is essential to follow a well-defined and proven method of managing its risk while simultaneously maximizing its potential for success. The key elements of AltaQuest's growth strategy are as follows:

- *focus on high quality, "company making" exploration plays in the United Kingdom*
- *support international exploration by fully exploiting domestic properties*
- *maintain a low finding and operating cost structure to optimize netbacks*
- *invest in large, contiguous undeveloped land blocks*
- *build an inventory of prospects based on common geological features*
- *retain operatorship of and high working interests in core areas to control resource development*

United Kingdom

AltaQuest has focused its exploration efforts in onshore United Kingdom where there are significant operating advantages. This area is underexplored due to the historical focus on North Sea development, and holds tremendous potential for large, multi-zone discoveries. Oil and gas licenses in the United Kingdom are awarded for a minimum six year period which allows for full regional geological analysis prior to drilling. Most importantly, the government does not impose royalties or taxes which results in high netbacks. In addition, there is excellent infrastructure and access to facilities in onshore United Kingdom.

In 1997, AltaQuest drilled a large seismically defined anomaly which resulted in a significant exploration success. AltaQuest owns a large 2D seismic database covering most of its unexplored acreage. The Fiskerton well confirmed the existence of a new pool that may generate production similar to the established Welton pool in the vicinity. Development drilling of a five well program will begin in mid 1998. In February 1998, AltaQuest acquired 196,000 acres (83,000 net) surrounding its current land position, and that immediately added six prospects to its inventory. The Company plans to shoot 210 kilometers of 2D seismic and expects to drill up to eight wells on this acreage over the next three years.



United Kingdom Exploration

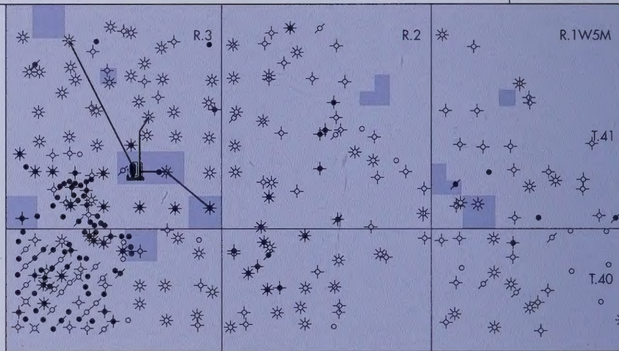
Land Position	*442,000 gross acres*
Ownership	*24.5 - 50% working interest*
	47% operated by AltaQuest
Seismic Data:	*350 kilometres of proprietary and trade seismic*
1998 Drilling Plans	*5 development wells*
	3 exploration wells
Exploration Program	*continue to evaluate sixteen additional,*
	seismically defined exploration prospects

Fiskerton

Land Position	*149,928 gross acres*
Ownership	*24.5% working interest*
Reserve Potential	*20 Mbbls*
Production Potential	*7,500 bopd*
Development Potential	*20 wells*
Potential Capital Expenditures	*$25 million*
1998 Development Program	*5 delineation wells*

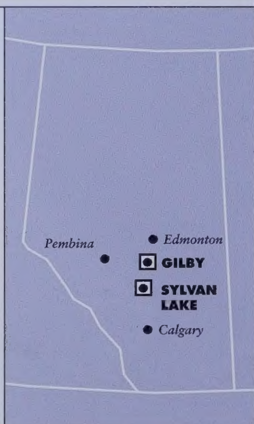
Sylvan Lake

	Avg. W.I.	Potential Reserves
AltaQuest Land		
five drilling locations	44%	2 Mmbbls
Potential Prospects		
six drilling locations	50%	5 Mmbbls
nine seismic options	50%	5 Mmbbls



Sylvan Lake

Western Canada



In 1997, AltaQuest developed a solid production base by acquiring several producing properties in a relatively mature area of Western Canada. The most significant acquisition occurred in December for properties near Sylvan Lake, Alberta that added over 300 BOE/d of production and substantial reserves, enabling the Company to achieve critical mass. Through an aggressive exploitation program in 1998 consisting of development drilling and other activities, AltaQuest believes it will be able to generate sufficient production and cash flow to support its exploration efforts in the United Kingdom. AltaQuest's domestic properties contain exploration upside as well.

Operating Overview

Undeveloped Land

(as at December 31, 1997)	Gross Acres	Net Acres
Alberta	42,648.9	18,947.5
Saskatchewan	3,160.0	1,580.0
Manitoba	6,919.4	958.1
Total Canada	52,728.3	21,485.6
United Kingdom	246,080.0	132,884.4
Total	298,808.3	154,370.0

This table does not reflect the eighth round of new well licenses in the U.K. of 196,000 acres (83,000 acres - net).

Reserves

	Reserve volume		Present value of future revenue ($000s) Discounted at		
	Oil & Ngls (mbbl)	Natural gas (Mmcf)	10%	15%	20%
Proven Reserves					
Producing	276.3	7,417.3	10,443	9,212	8,262
Non-Producing	122.7	1,807.9	2,571	2,182	1,898
Total Proven	399.0	9,225.2	13,014	11,394	10,160
Probable Reserves	318.3	788.3	3,373	2,752	2,303
Total	717.3	10,013.5	16,387	14,146	12,463

Figures shown are on a before royalty basis and include the Alberta Royalty Tax Credit. The probable reserves value has been risked at 50%.

Production Profile

Current Production	650 BOE/d
	Gas: 5.0 mmcf/d
	Oil and NGLs: 150 BOPD
1998 Average Projected Production	900 BOE/d
	Gas: 5.8 mmcf/d
	Oil and NGLs: 320 BOPD
1998 Targeted Exit Rate	1500 BOE/d
	Gas: 6.0 mmcf/d
	Oil and NGLs: 900 BOPD
	(U.K.: 630 BOPD)

Management's Discussion and Analysis of Financial Results

AltaQuest achieved public company status by successfully completing an offering on May 8, 1997 that raised gross proceeds of $2.5 million. This was a strategic and timely move that enabled the Company to accelerate its exploration efforts in the United Kingdom and to acquire producing properties in Western Canada that will underpin its operations for several years. One of AltaQuest's primary objectives in 1997 was to generate sufficient funding for its drilling program in the East Midlands. This goal was not only achieved, but also lead to significant exploration success. The discovery at Fiskerton has positioned AltaQuest for dramatic production and cash flow growth in the upcoming year, and its exploration efforts will continue on the new, recently acquired acreage. This will be supported by the general exploitation of AltaQuest's producing properties at Sylvan Lake, Alberta. Fiscal 1997 was the Company's first full year of operations with cash flow from operations rising to $467,000 from a loss in 1996.

Production Revenue

Oil and gas production revenue increased five-fold to $1.47 million in 1997 from $270,000 in 1996 as a result of higher production of 203 BOE/d, reflecting AltaQuest's first full year of operations. At a conversion rate of one barrel for 10 mcf, the Company's 1997 production was 85% natural gas and 15% crude oil and NGL's which was essentially the same as the revenue contribution. Average sales prices were $1.97/mcf and $20.40/bbl versus $1.76/mcf and $21.88/bbl respectively last year. The Company exited the year at a production level of 650 BOE/d, and expects to generate significantly higher production volumes and revenue in 1998.

Royalties and Alberta Royalty Tax Credit (A.R.T.C.)

AltaQuest's royalty expense, net of A.R.T.C., increased to $256,000 during the year from $13,000 in 1996. The Company's average royalty rate before A.R.T.C. was 23.5% in 1997 compared to 14% in 1996. The increase reflects the 11% rise in product prices on a BOE basis and the price sensitive royalty structure in Alberta. On a BOE basis, the net royalties were $3.45/bbl versus $0.86/bbl last year.

Not all the Company's crown royalties in Alberta are eligible for the royalty credit due to AltaQuest's "association" with its major shareholder. This association ceased to be a factor pursuant to the Company's initial public offering in May 1997. Royalties on a percentage basis will be lower in 1998 as the United Kingdom production is not subject to royalties.

Operating Expenses

On an absolute dollar basis, operating expenses increased to $357,000 in 1997 from $64,000 the previous year. On a BOE basis, operating expenses were $4.82/bbl versus $4.26/bbl which is a 13% increase over 1996. The Company expects to achieve similar rates in 1998. While netbacks for onshore United Kingdom production will be higher than netbacks achievable domestically, operating expenses should be greater than domestic levels as a result of higher United Kingdom cost structures.

Field Netbacks by Product

	Oil & NGL $/bbl	Gas $/mcf	Combined $/BOE	Combined 1996
Production volumes	11,213	629,245	74,137	15,121
Field price	$ 20.40	$ 1.97	$ 19.81	$ 17.83
Royalties	(6.38)	(0.43)	(4.66)	(2.51)
A.R.T.C.	1.20	0.12	1.21	1.65
Operating expense	(5.12)	(0.48)	(4.82)	(4.26)
Field netback	$ 10.10	$ 1.18	$ 11.54	$ 12.71

General and Administrative Expenses

General and administrative costs more than doubled to $475,000 in 1997 from $206,000 in 1996 as a result of the Company's increase in activity, the recruitment of a full managerial team, and expenses associated with its start-up period. AltaQuest expects general and administrative expenses to increase on a dollar value basis in 1998 due to additional staffing and office space requirements; however, reductions should be achieved on a BOE basis as significant volume increases are forecast.

Interest Expense

The Company only incurred marginal interest costs in 1997 due to significant levels of cash and deposits. AltaQuest established a revolving credit facility subsequent to the year-end. The Company anticipates drawing on this facility in 1998 and expects to incur interest charges.

Depletion, Depreciation and Site Restoration

In 1997, AltaQuest's depletion and depreciation expense including a $2,500,000 ceiling writedown of the Canadian cost center was $3,288,000 versus $45,000 last year. On a BOE basis, at a conversion rate of six mcf to one barrel of oil, depletion and depreciation, exclusive of the writedown, totalled $6.79 in 1997 up from $1.82 the previous year. Higher depletion is a reflection of increased finding costs and growth in production volumes. The depletion rate was 5.9% in 1997. Included in the above figures was a site restoration provision of $27,600 versus $2,000 in 1996. In 1998, the Company's depletion and depreciation is expected to increase as production levels rise; however, the rate per BOE should be lower than the 1997 total.

Income Taxes

AltaQuest neither paid cash taxes in 1997 nor provided for deferred taxes. Any deferred tax provision would have resulted in a debit balance on the balance sheet and was not recorded due to the uncertainty surrounding the potential reversal. Income tax pools available to reduce the future payment of cash taxes are shown in the table below and are expected to shelter the Company from paying current income taxes for several years.

Summary of Tax Pools

Undepreciated capital cost	$ 2,669,194
Canadian oil and gas property expense	9,420,631
Canadian development expense	149,150
Canadian exploration expense	933,704
Share issue expenses	373,159
	$ 13,545,838

Cash flow From Operations and Net Losses

Cash flow from operations increased substantially to $467,000 in 1997, from an insignificant loss experienced in 1996, due to higher production volumes, stronger product prices and a full year of operations. On a netback basis, cash flow totalled $6.30/BOE in 1997. Based on the average weighted outstanding shares of 9,583,000, cash flow from operations was $0.05 per share. As a result of a higher depletion and depreciation expense in 1997, AltaQuest incurred a loss of $2,821,000 during the year which equates to $0.29 per share versus a loss of $47,000 in 1996. In 1998, AltaQuest expects an increase in its cash flow and production volumes due to producing property acquisitions made late in 1997 and the development of the Fiskerton discovery.

Capital Expenditure Program

The Company engaged in a significant capital expenditure program during its first full year of operations, totalling $13.2 million as compared to $1.9 million in 1996. Over 85% of these expenditures related to property acquisitions. Financing for this program was provided by working capital and credit facilities arranged subsequent to fiscal year-end.

Financial Resources and Liquidity

During 1997, the Company issued 2.4 million common shares for net proceeds of $2.8 million. Another 840,750 warrants remained unexercised at year-end that could raise proceeds of $1.26 million prior to their expiry in May 1998. AltaQuest enters fiscal 1998 with cash and deposits of $1.6 million. In combination with bank financing of $7.2 million, these funds were used to complete a producing property acquisition that closed in mid February 1998. The Company expects to spend approximately $5.0 million on drilling, land, seismic and equipment in 1998 which will be financed by cash flow, bank borrowings and proceeds from the exercise of warrants.

Share Information

Pursuant to the Company's initial public offering on May 8, 1997, AltaQuest's common shares were listed for trading on The Alberta Stock Exchange. At December 31, 1997, there were 10,567,683 shares issued and outstanding which equates to a market capitalization of $24,835,000 on that date.

Industry Risks and Uncertainties

The oil and gas industry is one subject to numerous risks. The risk associated with finding hydrocarbons is high and a large amount of capital must be invested to find commercial quantities. Other risks include the volatility of product prices and the fluctuation in exchange rates associated with foreign benchmark pricing, interest rates, government policies, and regulations regarding the protection of the environment.

To manage these risks, AltaQuest has assembled a highly qualified management team. The Company has focused its activity in a geographic area with numerous opportunities where the government does not currently impose royalties, thus creating higher cash netbacks that help mitigate price uncertainty. The Company will also enter into hedging contracts on a portion of its production to guarantee a certain level of future revenue. Prior to carrying out its activities in the field, the Company established a comprehensive insurance program to offset the potential loss associated with drilling and producing hydrocarbons. AltaQuest will strive to maintain a debt to cash flow ratio of less than two to one, and reinvest its cash flow only on exploration and development prospects at this time.

Year 2000

AltaQuest has begun the process of looking at its computer systems to assess potential issues and costs associated with the year 2000. The issue revolves around the fact that many computer systems and software applications have been designed to recognize dates using only the last two digits of the year. In the year 2000, it is anticipated that many systems and programs will not function property. The Company will begin to address this issue in 1998, and any costs associated with mitigating this problem will be expensed.

MANAGEMENT'S REPORT

Management is responsible for the accompanying consolidated financial statements and for the consistency between the financial statements and other financial information contained throughout the annual report. To this end, the financial statements have been prepared using generally accepted accounting principles accepted in Canada, estimates and careful judgement.

The integrity of these financial statements requires that management maintains a system of internal controls to provide reasonable assurance that assets are safeguarded from loss and that the financial information is reliable, accurate and produced in a timely manner.

External auditors appointed by the shareholders have conducted an independent examination of corporate and accounting information in order to express their audit opinion as it appears below. The Audit Committee, consisting of external directors, has reviewed these statements with management and the auditors and has reported to the Board of Directors. The Board had approved the consolidated financial statements on the recommendation of the Audit Committee.

John E. Thompson
President
March 22, 1998

L. Neale Cruickshank
Vice-President, Finance

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of AltaQuest Energy Corporation as at December 31, 1997 and 1996 and the consolidated statements of operations and deficit and changes in financial position for the year ended December 31, 1997 and for the period from incorporation on March 28, 1996 to December 31, 1996. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1997 and 1996 and the results of its operations and the changes in its financial position for the year ended December 31, 1997 and for the period from incorporation on March 28, 1996 to December 31, 1996 in accordance with generally accepted accounting principles.

KPMG

Calgary, Alberta, Canada
March 22, 1998

KPMG
Chartered Accountants

Consolidated Balance Sheets

December 31,	1997	1996
Assets		
Current assets:		
Cash and deposits	$ 1,620,333	$ 3,194,513
Accounts receivable	932,733	261,922
	2,553,066	3,456,435
Petroleum and natural gas properties (Note 3)	11,671,842	1,851,015
	$ 14,224,908	$ 5,307,450
Liabilities		
Current liabilities:		
Accounts payable and accrued liabilities	$ 9,099,855	$ 143,739
Long term debt (Note 4)	6,080	8,804
Future site restoration provision	29,602	2,000
Shareholders' Equity		
Share capital (Note 5)	7,956,738	5,199,679
Deficit	(2,867,367)	(46,772)
	5,089,371	5,152,907
Subsequent event (Note 4)		
	$ 14,224,908	$ 5,307,450

See accompanying notes to the consolidated financial statements.

Approved by the Board

Director

Director

Consolidated Statements of Operations and Deficit

Year ended December 31, 1997 and for the period from incorporation on March 28, 1996 to December 31, 1996	1997	1996
Revenue		
Oil and gas production	$ 1,468,450	$ 269,604
Alberta Royalty Tax Credit	89,544	24,898
Royalties	(345,129)	(37,978)
Interest income	86,937	12,544
	1,299,802	269,068
Expenses		
Operating	357,384	64,378
General and administrative	475,293	206,462
Depletion and depreciation	3,287,720	45,000
	4,120,397	315,840
Net loss	(2,820,595)	(46,772)
Deficit, beginning of period	(46,772)	–
Deficit, end of period	$ (2,867,367)	$ (46,772)
Loss per common share	$ (0.29)	$ (0.03)

See accompanying notes to the consolidated financial statements.

Consolidated Statements of Changes in Financial Position

Year ended December 31, 1997 and for the period from incorporation on March 28, 1996 to December 31, 1996	1997	1996
Operating Activities		
Net loss	$ (2,820,595)	$ (46,772)
Item not involving cash:		
Depletion and depreciation	3,287,720	45,000
Funds generated from operations	467,125	(1,772)
Change in non-cash operating working capital	(51,080)	(121,211)
	416,045	(122,983)
Investing Activities		
Petroleum and natural gas properties	(13,235,945)	(1,894,015)
Proceeds on sale of properties	155,000	–
Change in non-cash working capital related to investing	8,336,385	–
	(4,744,560)	(1,894,015)
Financing Activities		
Issue of common shares and warrants, net	2,757,059	5,199,679
Repayment of long term debt	(2,724)	11,832
	2,754,335	5,211,511
Increase (decrease) in cash and deposits	(1,574,180)	3,194,513
Cash and deposits, beginning of period	3,194,513	–
Cash and deposits, end of period	$ 1,620,333	$ 3,194,513

See accompanying notes to the consolidated financial statements.

Year ended December 31, 1997 and for the period from incorporation on March 28, 1996 to December 31, 1996

AltaQuest Energy Corporation's (the "Company") principal business activity is the acquisition, exploration, development and production of oil and gas properties in both Western Canada and the United Kingdom (U.K.) through its 100% owned subsidiary, AltaQuest Energy Corporation (UK) Limited. The Company was incorporated March 28, 1996, thus the 1996 results are from that date forward.

1. Significant Accounting Policies

Basis of presentation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary. These statements have been prepared in accordance with generally accepted accounting principles in Canada and reflect the policies as described below.

Petroleum and natural gas properties

The Company follows the full cost method of accounting for petroleum and natural gas activities whereby all costs, net of incentives, related to the acquisition of, the exploration for and development of oil and gas reserves are capitalized into separate country cost centers. Costs include lease acquisition, lease maintenance on non-productive lands, geological and geophysical costs, drilling expenditures and related plant and production equipment costs. Proceeds on disposal of properties are deducted from capitalized costs without recognition of gain or loss except for dispositions which would alter the depletion rate by 20% or more. General and administrative expenses are not capitalized except to the extent of the Company's working interest in operated capital expenditure programs to which overhead fees have been charged pursuant to standard industry agreements.

Capital costs are depleted on the unit-of-production method based on estimated gross proven reserves as determined by independent engineers. Gas volumes are converted to equivalent energy units of oil on the basis of six thousand cubic feet of gas to one barrel of oil. Depreciation is provided on plants and facilities on a 5% straight-line basis and on a 20% and 30% declining balance basis for other equipment. As of the current year-end, activities in the U.K. have yet to reach a stage of commercial production. Therefore, all U.K. costs have been capitalized and the application of the unit-of-production depletion has not been applied.

The net book value of capital costs on a country by country basis is limited to estimated future net revenues from the production of proved reserves based upon current product prices. Additional depletion is provided if the net book value exceeds the net revenue plus the value of undeveloped lands, less future general and administrative expenses, future site restoration and abandonment costs, financing costs and income taxes. Pursuant to the application of this test on the Canadian cost center the Company has reflected an additional depletion charge of $2,500,000 (1996 - Nil).

The amounts recorded for depletion and depreciation and the provision for future site restoration costs are based on estimates. The ceiling test calculation is based on such factors as estimates of proved reserves, production rates, product prices and future costs. By their nature, these estimates are subject to measurement uncertainty and may impact the financial statements of future periods.

Future site restoration

Provisions for future site restoration costs are provided for on a unit-of-production basis using estimates based upon current regulations and industry standards. The annual charge is included in depletion expense and actual restoration costs are charged to the provision as incurred. As of December 31, 1997 the estimated future site restoration costs to be accrued over the life of the remaining proven reserves is $470,000 (1996 - $40,000).

Foreign currency translation

The Company's U.K. activities are denominated in British pound sterling and are considered dependent, financially and operationally, upon its parent. Monetary assets and liabilities are translated at rates of exchange in effect at year-end while non-monetary assets and liabilities are translated at historic rates of exchange. Revenue and expenses are translated at prevailing rates of exchange on the transaction date.

Translation gains and losses are included in earnings, except for unrealized gains or losses on long-term monetary items which would be deferred and amortized over the expected term of settlement.

Financial instruments

The carrying values of current assets and current liabilities approximate their fair value due to the relatively short period to maturity of the instruments. The fair value of the obligations under capital lease is not materially different than its carrying value.

Joint venture operations

Substantially all of the Company's exploration and production activities are conducted jointly with other entities and accordingly the accounts reflect only the Company's proportionate interest in such activities.

2. Acquisitions

On September 10, 1996 the Company acquired all of the outstanding shares of two U.K. companies, Trans World Oil & Gas (UK) Limited and Trans World Oil Products Limited, from the Company's significant shareholder. Consideration for the sale consisted of 1,000,000 common shares recorded at a value of $630,385, being the carrying amount of the net assets of the acquired companies. The assets acquired consist of undeveloped petroleum and natural gas acreage in the U.K. and related geophysical data.

On September 17, 1996 the Company acquired certain petroleum and natural gas interests from the Company's significant shareholder. Consideration for the sale consisted of 1,150,000 common shares at a value of $546,000, being the carrying amount of the acquired assets and the related net revenue with respect to the interests from the effective date recorded by the shareholder. The oil and gas revenue net of royalties and operating expenses for the nine months ended

December 31, 1996 relating to the property were $491,475 and $146,190 respectively. Of these amounts, revenue in the amount of $244,170 and operating expenses in the amount of $64,378 have been included in the consolidated statement of operations which are the operating results of the property from the date of the acquisition to December 31, 1996. Revenue net of operating expenses from April 1, 1996 to September 16, 1996 has been deducted from the carrying amount of the interests.

3. Petroleum and Natural Gas Properties

	1997		1996	
	Cost	Accumulated depletion and depreciation	Cost	Accumulated depletion and depreciation
Petroleum and natural gas properties	$ 12,348,983	$ 3,179,630	$ 1,697,677	$ 37,000
Production equipment and facilities	2,505,272	92,950	116,002	–
Other equipment	120,706	30,539	80,336	6,000
	$ 14,974,961	3,303,119	$ 1,894,015	$ 43,000
Net book value		$ 11,671,842		$ 1,851,015

Undeveloped property expenditures of $500,000 (1996 - $389,750) have been excluded from capitalized costs for depletion purposes. Included above are $1,042,810 (1996 - $841,741) of petroleum and natural gas properties in the U.K. that have not been depleted.

4. Long Term Debt

The long term debt consists of an outstanding capital lease obligation, the current portion of $3,008 being reflected in current liabilities. Repayments required to retire this obligation are as follows: 1999 - $4,037 and 2000 - $2,043.

Subsequent to year-end, the Company established a revolving credit facility of $6,000,000. This loan bears interest at bank prime plus three eights of a percent and no principal payments are currently due or scheduled. In addition, the Company obtained a non-revolving bridge loan of $1,200,000 in order to assist with financing a producing property acquisition that closed subsequent to year-end. Security for this indebtedness is provided by a general assignment of accounts receivable and a $25,000,000 demand debenture conveying a first floating charge over the Company's principal properties.

5. Share Capital

The Company is authorized to issue an unlimited number of common shares and an unlimited number of first and second preferred shares of which none are outstanding. Changes in issued common shares are as follows:

	1997		1996	
	Number of shares	Amount	Number of shares	Amount
Common Shares				
Balance, beginning of period	5,158,433	$ 2,141,050	–	–
Issued pursuant to exercise of special warrants	3,000,000	3,058,629	–	–
Issued pursuant to exercise of warrants	2,159,250	2,738,875		
Issued for acquisition of property	–	–	1,150,000	546,000
Issued for acquisition of U.K. companies	–	–	1,000,000	630,385
Issued for cash	250,000	250,000	3,008,433	1,180,372
Share issue expenses	–	(231,816)	–	(215,707)
Balance, end of period	10,567,683	$ 7,956,738	5,158,433	2,141,050
Special warrants				
Balance, beginning of period	3,000,000	3,058,629	–	–
Special warrants issued for cash	–	–	3,000,000	3,058,629
Conversion of warrants	(3,000,000)	(3,058,629)	–	
Balance, end of period	–	–	3,000,000	3,058,629
Total amount		$ 7,956,738		$ 5,199,679

Pursuant to a Public Offering of May 8, 1997, the Company issued 1,000,000 Warrants that entitle the holder to acquire one common share, at an exercise price of $1.50 per share, at any time prior to May 8, 1998. As of December 31, 1997, 159,250 warrants had been exercised for proceeds of $238,875.

In 1996, the Company had reserved for issuance 375,000 common shares, at a price of $1.00 per share, pursuant to a subscription agreement with a significant shareholder. During 1997, the Company issued 250,000 common shares pursuant to the terms of that agreement. As of December 31, 1997, 125,000 common shares remain to be issued; 62,500 on each of March 1, 1998 and June 1, 1998

Under the Company's Officers, Directors and Employees Stock Option Plan, the Company can reserve up to 10% of the outstanding shares. As of December 31, 1997, options to purchase 1,030,000 common shares (1996 - 492,500) were outstanding at prices between $1.00 and $1.25. These options expire at various dates through the year 2002.

6. Per Share Information

Earnings per share are based upon the weighted average number of shares outstanding during the year, which were 9,582,917 shares (1996 - 1,785,716). Fully diluted earnings per share, as affected by outstanding warrants, stock options and the subscription agreement, is not disclosed as it is not dilutive.

7. Income Taxes

The income tax provisions differ from taxes which would result had the Company applied the combined federal and provincial statutory rates of 44.6% to earnings. The reasons for these differences are disclosed in the following table.

Oil and gas properties with a net book value of $310,310 (1996 - $329,696) have no cost basis for income tax purposes. This difference arose as a result of a property acquisition with no tax values.

	1997	1996
Computed income tax expense (recovery)	$ (1,257,985)	$ (20,860)
Add (deduct) the effect of:		
Crown charges disallowed	138,586	16,938
Alberta Royalty Tax Credit	(39,937)	(11,105)
Non-deductible depletion	8,646	7,582
Resource allowance	(67,497)	–
Tax benefit of losses not recognized	1,213,987	4,311
Other	4,200	3,134
Tax reflected in accounts	$ –	$ –

8. Segmented Information

The Company conducts its oil and gas activities in both Western Canada and the United Kingdom. Operations in the U.K. have not reached commercial productive capability, therefore all reported revenues and expenses are attributable to the Canadian geographic segment.

	1997		1996	
	Canada	U.K.	Canada	U.K.
Identifiable assets	$10,629,032	$1,042,810	$1,009,274	$841,741
Segment capital expenditures	$13,034,876	$ 201,069	$1,052,274	$841,741

9. Related Party Transactions

The Company has entered into a joint venture agreement with a significant shareholder that provides for mutual rights of participation in drilling prospects and property purchases, within certain limits. The shareholder has agreed to provide certain administrative services to the Company through to the expiry of the agreement on August 31, 1998. At December 31, 1997 the Company is owed $6,403 (1996 - $85,260) with respect to this agreement.

Corporate Information

Corporate Officers

John E. Thompson
President & Chief Executive Officer

L. Neale Cruickshank
Vice President, Finance & Chief Financial Officer

Damon L. Olsen
Vice President, Exploration

D.T. (Dan) Wilson
Vice President, Engineering

Robert A. Lehodey
Corporate Secretary
Calgary, Alberta

Directors

R. Bradley Hurtubise
Calgary, Alberta

Bruce R. Libin
Calgary, Alberta

Joe Phillips, Jr.
Calgary, Alberta

John E. Thompson
Calgary, Alberta

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Stock Exchange Listing

Alberta – Trading Symbol AQF

Registrar & Transfer Agent

CIBC Mellon Trust Company

Bankers

National Bank of Canada
Canadian Imperial Bank of Commerce

Auditors

KPMG

Evaluation Engineers

Paddock Lindstrom & Associates Ltd.

Solicitors

Bennett Jones Verchere

Abbreviations

bbls	–	*barrels*
mbbls	–	*thousand barrels*
Mmbbls	–	*million barrels*
mcf	–	*thousand cubic feet*
Mmcf	–	*million cubic feet*
ngls	–	*natural gas liquids*
BOE	–	*barrel of oil equivalent*

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